Commission to allow them to set depreciation rates based on the economic lives of their plant.[102] Second, they contend, sharing discourages investment in new services and the regulated infrastructure, since it places a limit on regulated earnings.[103] Third, the LECs believe the existence of sharing gives LECs the ability to cross-subsidize competitive services by raising rates of less competitive services.[104] Finally, the LECs argue sharing is no longer needed as a backstop mechanism for the productivity factor.[105]

Just as the Commission must continue its oversight of the LECs' depreciation rates to allow it to assess claims of LEC under- or over-earning,[106] so must it continue to ensure the reasonableness of LEC rates of return.[107] Under the sharing mechanism, the LECs are allowed a broad range of earnings. Despite their vocal protests, the LECs have failed to demonstrate that the opportunity to earn 14.25 percent (15.25 percent if the LECs elect the higher 4.3 percent

[102] See, e.g., USTA Comments, p. 48; GTE Comments, p. 48; and Bell Atlantic Comments, p. 9.

[103] See, e.g., Southwestern Bell Comments, p. 43; USTA Comments, p. 46; and NYNEX Comments, p. 29.

[104] See, e.g., USTA Comments, p. 48, n.127; and Bell Atlantic Comments, p. 10.

[105] See, e.g., GTE Comments, p. 67; and Pacific Telesis Comments, p. 44.

[106] 47 U.S.C. § 220 (mandating that Commission establish depreciation rates).

[107] 47 U.S.C. § 201 (mandating that Commission ensure that rates remain just and reasonable).

productivity factor) limits their ability to attract capital[108] or invest in new services or infrastructure.[109] As long as the LECs maintain market power -- and they do in the access arena -- the Commission must ensure they do not achieve monopoly profits on their non-competitive services.

In addition to these concerns, MCI is troubled by the effect that the elimination of sharing would have on the traditional remedies the Commission uses to enforce its rules. Whether in an audit of cost allocation rules or other non-structural safeguards, in a Section 208 complaint, or in a Section 204 or 205 tariff investigation, the Commission has relied on its ability to order refunds based on a calculation of ratepayer harm. For example, where an audit results in a finding that a cost allocation rule was violated, e.g., resulting in an overallocation to regulated operations of a particular amount, the Commission would typically order a refund to ratepayers -- either in the form of a check or in the form of a future rate decrease. Under price caps, the remedy has been adjusted to reflect the new form of regulation -- the price cap itself is lowered, which may result in rate decreases and certainly reduced pricing flexibility.[110]

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[108] See, e.g., USTA Comments, pp. 46-47; and US WEST Comments, pp. 43-45.

[109] In any case, the LECs are allowed pricing flexibility in pricing their new services. That is, they have flexibility to assign overhead loadings to new services, and can justify higher rates of return for investment in particularly risky new services.

[110] The GTE Telephone Operating Companies, AAD 94-35, Consent Decree Order, Released April 8, 1994.

However, these kinds of calculations depend upon the Commission's ability to quantify the harm to ratepayers. If there is no upper earnings limitation, no quantification is possible because the rule violation cannot result in over-earnings.[111]

This outcome drastically reduces the Commission's clout in enforcing cost allocation rules. No longer could the Commission force LECs to disgorge profits won by violations of Commission requirements. Enforcement action would be limited to the imposition of fines. While embarrassing to the carrier at the receiving end of the fine, the dollars at stake are nowhere near the level necessary to discourage bad behavior.[112]

Evisceration of the Commission's enforcement authority would be unimportant if the cost allocation rules and host of other non-structural safeguards had faded in significance. That, however, is not the case. Indeed, BOC entry into nonregulated and adjacent markets[113] increases opportunities for cost-shifting and anti-competitive behavior. At a time of emerging competition for LEC access services, the Commission should not lessen its ability to enforce the very rules it created to foster competition.

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[111] See Notice of Apparent Liability for Forfeiture, FCC 93-407 (released August 27, 1993)(proposing to fine AT&T for its failure to get Commission approval for bundling enhanced services).

[112] Southwestern Bell Telephone Company, AAD 94-57, FCC 94-114, released May 19, 1994 (Com. Car. Bur.)(finding violations potentially totalling $90 million).

[113] See Telephone Company-Cable Television Cross-Ownership Rules, CC Docket No. 87-266, 7 FCC Rcd 5781 ("Video Dialtone Order").

The LECs' concern that sharing allows them to cross-subsidize their more competitive services by increasing rates for their less competitive services is admirable. The correct response by the Commission to this possibility is to design the baskets and bands in such a way that this not possible (e.g., by continuing oversight of baskets and service categories to segregate services subject to emerging competition from non-competitive services). Eliminating sharing would not by itself eradicate this behavior.

BASELINE ISSUE 5: COMMON LINE FORMULA

Baseline Issue 5a: Whether the Commission should reconsider its use of the Balanced 50/50 formula to cap common line charges.

The Common Line Basket must be capped differently than the other access categories to reflect the traffic sensitive recovery of non-traffic sensitive costs. How the basket is capped determines whether the IXCs or the LECs individually or together share (as through the current Balanced 50/50 formula) the benefit of the downward reduction in costs that normally would be associated with an increase in demand for a traffic sensitive service. Some LECs commenting in the instant proceeding wish to amend the plan to retain the entire benefit for themselves,[114] while others are willing to maintain the status quo.[115] MCI has

[114] See, e.g., US WEST Comments, p. 44 (urging simplification of price caps through elimination of the separate common line adjustment formula; and Bell Atlantic Comments, p. 17 (characterizing current formula as "distortion" to price caps).

long argued in favor of adoption of a per-line formula for establishing the cap for the Common Line Basket, which flows through all of the benefits of common line demand growth to the interstate ratepayers who are responsible for generating it. As MCI reiterated in its comments, "the Balanced 50/50 formula unduly minimizes the contribution that IXCs make to common line growth stimulation, while overstating the LEC's ability to do so."[116]

LEC arguments for retaining the current Balanced 50/50 formula are void of persuasive or supporting evidence. NYNEX contends that the current formula has put downward pressure on common line rates,[117] without regard for the fact that all but two of the BOCs filed 1994 carrier common line ("CCL") rates at the maximum amount allowed under the current formula.[118] NYNEX also is concerned that abandonment of the current formula would "eliminate the incentives to the LECs" to grow interstate access demand,[119] but it does not acknowledge that the LECs have failed to respond to those incentives because, MCI believes, they lack the necessary influence to actually affect interstate access demand. USTA also argues for retention of the current formula. Erroneously,

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[115] See, e.g., Rochester Comments, p. 20 (contending current formula offers appropriate balance of gains between LECs and IXCs); and NYNEX Comments, p. 48 (arguing Balanced 50/50 formula has resulted in CCL rate reductions).

[116] MCI Comments, p. 35.

[117] NYNEX Comments, p. 48.

[118] Only NYNEX and US WEST proposed to price minimally below the Common Line Basket cap.

[119] NYNEX Comments, pp. 48-49.

USTA suggests that nothing has changed since adoption of the Balanced 50/50 formula to alter the Commission's view that LECs (and IXCs) contribute to common line growth.[120] Not only is this assertion facially incorrect, but it blatantly disregards the two reasons the Commission gave for initially adopting the Balanced 50/50 formula instead of the per-line formula: "to ensure that no 'potential sources of increased productivity' were discouraged";[121] and because it would "protect consumers against rate increases that might result from decreases in usage per line."[122]

The most significant change that has happened in the years since the adoption of price caps is that more LEC performance data have been captured to facilitate Commission evaluation of many of the decisions it adopted in the original price cap proceeding. For example, the LECs' inability to stimulate common line demand above the 8 percent break-even mark shows that adoption of the per-line formula would not have quashed LEC incentive since the LECs clearly do not have the ability to influence common line growth to any material degree. That is, unless the LECs stimulated growth to at least 8 percent, they would (and did) receive less benefit from common line growth than they would have under the per-line formula that they opposed during the initial price cap proceeding. Despite this strong incentive, the LECs have been incapable of

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[120] USTA Comments, p. 85, n.217.

[121] Sprint Comments, p. 12, citing 5 FCC Rcd at 6795.

[122] Id. at 16, citing NPRM, at para. 70.

achieving even this modest level of growth,[123] while IXCs such as MCI experienced increases in market share from 15.3 to 18.4 percent.[124] Clearly, had the LEC "marketing initiatives, service innovations and network investment activities"[125] been able to contribute to common line minutes-of-use growth, the LECs would have achieved -- or even exceeded -- the 8 percent break-even mark.[126] Since LECs lack the ability to stimulate demand, retention of one formula over another in order to not deprive the LECs of a potential source of incentive is a hollow fear that has no role in determining the proper formula.

Nor has the Commission's second fear materialized. As Sprint notes, "[t]here have been no instances of prolonged negative growth per common line."[127] Indeed, since experience has shown that the Commission's apprehension with adopting the per-line formula has failed to materialize, MCI urges the Commission to institute the per-line formula now because it can provide the results that the Balanced 50/50 formula has failed to achieve. First, it appropriately rewards those parties who have control over demand growth with the benefits that ensue from increasing demand. Also, it would create additional

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[123] See MCI Comments, p. 22, n.36 (illustrating decline from 10.77% to 5.83% in CCL minutes-of-use growth since initiation of price caps).

[124] MCI Comments, p. 37, n.66, citing Long Distance Market Shares: Fourth Quarter, 1993 released April 15, 1994.

[125] USTA Comments, p. 85, n.217.

[126] MCI Comments, p. 37.

[127] Sprint Comments, p. 16.

incentives for the IXCs to stimulate demand. Finally, it would have no diminishing impact on the LECs' incentives to reduce their costs or invest in network technology.

LEC arguments that the separate Common Line Basket formula should be eliminated to simplify the price cap formula[128] or to remove an unnecessary distortion[129] should be recognized for what they are: self-serving and unsubstantiated solicitations to enable LECs to receive the entire benefit realized from common line demand stimulation. So long as non-traffic sensitive costs are recovered using a rate structure that reflects traffic sensitivity, it is necessary to retain some method of reflecting lowered costs that should result from increased usage. Curiously, the LECs who promote elimination of the separate formula do not alternatively suggest increasing the productivity factor as a substitute means of simulating the appropriate cost/demand relationship. Instead, they opt for the arrangement that simply presents the LECs with 100 percent of any cost savings. The problem with this LEC scenario is that the LECs plainly lack the ability to significantly affect common line demand, and thus should not receive any, let alone all, of the cost savings associated with common line growth. Since the LECs have offered scant evidence that they should even share in the benefits of stimulated common line growth, their pleas for total demand growth benefits should be summarily rejected.

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[128] Bell Atlantic Comments, p. 17.

[129] US WEST Comments, p. 44.

<u>Baseline Issue 5b</u>: What method the Commission should use to cap common line charges.

The Commission should adopt the per-line formula to cap the Common Line Basket because it creates incentives for those parties who actually have control over common line growth: the IXCs. Other IXCs commenting in this proceeding support this position.[130] Sprint correctly recognizes that, "[b]ecause IXC efforts are the prime reason for increased average common line usage, the benefits of such usage growth may appropriately be given to the IXCs and ultimately to their customers."[131] Wiltel agrees that "the reward for stimulating demand growth over such non-traffic sensitive facilities should go to those carriers that are able to boost such usage: the purchasers of access services."[132]

AT&T correctly recognizes that "elimination of the 50/50 formula is fully justified, because that mechanism has failed to achieve its objective of encouraging growth in common line usage."[133] Such a result is not unanticipated since, as MCI has always recognized, it is the "IXCs -- and not the LECs -- [who] have the ability and market based incentives to stimulate demand growth."[134] Sprint concurs: "Because IXC efforts are the prime reason for increased average common line usage, the benefits of such usage growth may appropriately be

[130] <u>See</u>, <u>e.g.</u>, Sprint Comments, p. 15; and AT&T Comments, p. 26.

[131] Sprint Comments, p. 17.

[132] Wiltel Comments, p. 26, (footnote omitted).

[133] AT&T Comments, p. 26.

[134] MCI Comments, p. 38.

given to the IXCs and ultimately to their customers."[135] By rewarding those parties who have control over average common line usage with the benefits derived from increases in demand, the Commission can achieve its goal of just and reasonable rates for interexchange services.

Most significantly, however, under adoption of the per-line formula, LECs would retain the same underlying incentives they attribute to the Balanced 50/50 formula. First, as AT&T notes, "a per line cap creates appropriate incentives for LECs to increase their productivity (and hence reduce their costs) because this capping mechanism automatically reduces per-minute common line charges as demand increases."[136] In this way, the price cap formula would continue to reward those LECs who decrease their costs by allowing them to achieve profit levels above those attainable under rate of return regulation. Also, as Sprint notes, "a per-line formula would continue to reward those LECs that manage to reduce the average cost per line (as opposed to increasing the average usage per line), a cost over which the LECs should be able to exercise some control."[137] Further, as the IXCs achieve increases in common line demand, LECs would accrue financial benefits as demand for their network services increases,[138]

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[135] Sprint Comments, p. 17.

[136] AT&T Comments, p. 28, (footnote omitted).

[137] Sprint Comments, p. 16.

[138] As IXC minutes-of-use grow, the LECs receive nearly 40% of increased IXC revenues through increased access charges.

thereby also stimulating their incentive to respond to this demand through productivity-enhancing investments.

<u>Baseline Issue 5c</u>: How the Commission's adoption of a per-line charge should affect possible changes in the productivity factor or the composition of baskets.

NYNEX argues that "[t]he Commission should not adopt a per-line common line formula [because] . . . a change to the per-line formula would also require a modification of the productivity factor.[139] Since the Commission modified the productivity factor to reflect its original adoption of the Balanced 50/50 formula, readjusting the productivity factor to reflect the full pass-through of demand growth to access customers requires a revision to the Commission's short-term productivity study that MCI believes should be used to establish a revised productivity offset.

<u>BASELINE ISSUE 6: EXOGENOUS COST CHANGES</u>

<u>Baseline Issue 6a</u>: Whether the number of cost changes currently eligible for exogenous treatment under price caps should be reduced.

In the Notice, the Commission introduced an "economic cost" criterion by which it proposed to identify those cost changes that would be eligible for exogenous treatment.[140] This proposal received little support. MCI, for

[139] NYNEX Comments, pp. 48-49.

[140] <u>Notice</u>, 9 FCC Rcd at 1699.

example, expressed concern that exogenous costs would not be limited using this criterion because such costs would be difficult to define in a practical way.[141] Pacific Bell agreed that "[a]ttempting to define, let alone calculate 'economic costs' would be something else again, because no two economists agree on what they are."[142] USTA similarly rejects limiting exogenous costs to economic cost changes "because initial price cap rates were based on accounting costs."[143] Because the Commission's proposal would be difficult to apply on a practical basis, and because no party supports its adoption, MCI urges the Commission to abandon the proposal to use "economic" costs as a criterion for allowing exogenous treatment.

Though commenting parties agreed in their antipathy for an economic cost criterion, their unanimity regarding exogenous costs ends there. GTE seeks exogenous treatment for "costs outside [the LECs'] control and not in the GNP-PI,"[144] a definition that is so broad it would invite ad hoc decisions that unnecessarily consume both the regulator's and the access users' resources. The Ad Hoc Telecommunications Users' Committee endorses a similarly nebulous means of evaluating whether a cost should be afforded exogenous treatment. It recommends analysis of "how a cost change of the same type would likely be

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[141] MCI Comments, p. 45, n.78.

[142] Pacific Telesis Comments, p. 54.

[143] USTA Comments, p. 86.

[144] GTE Comments, p. 78.

responded to by nonregulated firms in competitive industries."[145] NYNEX urges the Commission to retain the existing rules.[146] As MCI explains in response to Baseline Issue 6b, infra, the number of exogenous costs should be reduced to enhance the efficiency incentives under price caps and to decrease the administrative burdens associated with voluminous exogenous cost showings.

Baseline Issue 6b: Which cost changes should be eligible for exogenous treatment under price caps.

As explained in MCI's comments, allowing carriers to treat certain costs exogenously is a feature of price cap regulation in need of a fundamental overhaul. MCI recommends that the Commission repudiate the existing theory underlying exogenous costs -- i.e., costs beyond a carrier's control -- because the theory has produced an endless parade of "costs" that must be examined to determine if they qualify for exogenous treatment and if they are overstated. In addition to creating issues that are difficult to resolve,[147] the current theory and treatment of exogenous costs defeats the very purpose of incentive regulation: (1) it provides strong incentives for LECs to seek "cost-plus" treatment of any cost associated with a regulatory or legislative demand it virtually has canceled the

[145] Ad Hoc Telecommunications User Committee Comments, p. 26.

[146] NYNEX Comments, p. 57.

[147] See, e.g., Other Post Employment Benefits, 8 FCC Rcd 1024 (1993); 1993 Annual Access Order, 8 FCC Rcd 4960 (Com. Car. Bur. 1993); and Petition for Waiver of the Commission's Rules to Recover Network Depreciation Costs, Order, 9 FCC Rcd 377 (1993)(when is a FASB cost change reflected in GNP-PI?).

administrative savings promised by the Commission when it adopted price cap regulation.

MCI's proposed new exogenous cost standard would "include only those Commission-ordered changes that result in a shift in costs between the interstate and intrastate jurisdictions or between regulated and non-regulated operations."[148] This standard, by definition, would capture cost changes resulting from amendments to Parts 32, 36, or 64 of the Commission's Rules, but only if the cost changes produce a jurisdictional shift. Specifically, the Commission should delete exogenous treatment for the completion of the amortizations of inside wire and the depreciation reserve deficiency,[149] Transitional Support Fund obligations, tax effects, regulatory fees, and the discretionary category "other."[150]

Under MCI's proposed standard, only a few discrete categories of costs would be accorded exogenous treatment.[151] First, price cap carriers selling

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[148] MCI Comments, p. 42.

[149] These amortizations have expired, and therefore no longer require exogenous treatment. MCI Comments, p. 42.

[150] Id., at 43, 47.

[151] Southwestern Bell believes that "[t]o the extent that regulatory and legislative actions impose significant costs on a regulated firm, the regulatory body retains an obligation to provide some specific mechanism for recovery of those costs. Southwestern Bell Comments, p. 54. Southwestern Bell's argument is nothing more than a restatement of a fundamental ratemaking law -- a regulated entity's rates must be compensatory. While the imposition of a substantial cost might produce noncompensatory rates in certain circumstances, these can be addressed through waiver or rulemaking that creates unlimited case-by-case exceptions to the exogenous cost rule to avoid noncompensatory rates.

exchanges to rate of return carriers would adjust their price cap indexes "both to recognize their reductions in interstate plant and to remove the greater assignment to interstate costs due to increased subsidies that the acquiring carrier frequency will realize."[152] Further, the expiration of equal access expense amortizations would be recognized by requiring LECs to reduce their interstate rates accordingly.[153] Finally, changes in the Uniform System of Accounts ("USOA") or Generally Accepted Accounting Principles ("GAAP") could be treated as exogenous should be recognized only to the extent they meet the proposed test.[154]

The benefit of restating exogenous treatment is twofold. First, the disputes regarding a cost category's eligibility for exogenous treatment would be minimized, thereby reducing the administrative costs of trying to define rules on

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For this reason, MCI has supported exogenous treatment of the costs of implementing Billed Party Preference. MCI Comments, p. 48.

[152] MCI Comments, p. 47.

[153] Id., at 48. AT&T agrees that "[t]reating the expiration of equal access network reconfiguration expense amortization exogenously accords fully with the LEC price cap plan's treatment of amortization of other expense by those carriers . . . because that even would have reduced the LECs' rates under rate of return regulation." AT&T Comments, p. 51.

[154] BellSouth urges the Commission to allow these accounting changes to be accorded exogenous treatment "as the Commission shall permit or require." (BellSouth Comments, p. 56.) In many instances, however, USOA or GAAP changes result only in a change in the timing, not level, of costs. Since there is no overall change in the amount of costs to be recovered, exogenous treatment in one period for these costs would require off-setting treatment in another period. The administrative burden of tracking all such potential costs is avoidable if the Commission disallows exogenous treatment for them under MCI's proposed jurisdictional test.

an ad hoc basis. Second, the categories granted exogenous treatment would be reduced, thereby providing the LECs with greater incentive to maximize their productivity, in accordance with the Commission's price cap goals. MCI's proposal correctly identifies those costs that carriers should be able to pass through to their access customers.

Baseline Issue 6c: Whether the Commission should adopt an administrative process to allow access customers or other groups to request cost changes eligible for exogenous treatment and, if so, what should be the procedures in such an administrative process.

The LECs oppose the adoption of a flexible mechanism by which interested parties could recommend exogenous treatment for certain categories of costs.[155] Even though other parties can intervene in tariff filings (when, for example, LECs might fail to recognize a declining exogenous cost), not all changes in exogenous costs correspond so neatly with the schedule of the annual access filings. Adopting such a process would provide access customers with a means of ensuring that the LECs appropriately recognize all changes in access charges in a timely fashion.

[155] See, e.g., NYNEX Comments, p. 65; Pacific Telesis Comments, p. 55; and Southwestern Bell Comments, p. 54.

BASELINE ISSUE 7: SERVICE QUALITY, INFRASTRUCTURE MONITORING, AND NETWORK RELIABILITY

Baseline Issue 7a: Whether the Commission should increase or revise the monitoring of the LECs' network reliability, service quality, and infrastructure development.

So that LECs did not pursue increased profits under price caps by reducing the funds they previously directed toward customer service, the Commission initiated increased service quality reporting requirements. MCI believes that these requirements encourage the "maintenance of at least the same or higher LEC operating performance" and "appear to be effective in identifying potential service problems and alerting the industry."[156] Thus, MCI agrees with those parties who contend that the current level of monitoring does not need to be augmented.[157] Nor have there been any changes in the industry since the price cap plan began that would support reducing these service quality monitoring requirements, and the Commission should dismiss such suggestions. US WEST appeals that "the Commission should seriously consider eliminating tracking reports in their current form,"[158] and Southwestern Bell recommends that the Commission "rely on market forces to determine the appropriate level of service quality customers demand."[159] Any relaxation of the

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[156] MCI Comments, p. 50.

[157] See, e.g., Ameritech Comments, p. 20; GTE Comments, p. 79; NYNEX Comments, p. 53; and USTA Comments, pp. 92-93.

[158] US WEST Comments, p. 60.

[159] Southwestern Bell Comments, p. 63.

LEC reporting requirements is premature, given the lack of competition in both the local and interstate access service market segments. The LECs continue to have the incentive to increase their profits by reducing service quality. Also, if service quality declines, LEC customers continue to lack alternative service providers upon which they can rely. Until the such alternatives exist, it is inappropriate to relieve the LECs of these reporting requirements.

As LECs face effective competition, however, the need for monitoring will be reduced.[160] Thus MCI agrees with those commenting parties who believe that "the Commission [can] reduce existing reporting requirements once it determines that competition has developed in a particular access market."[161] This is because the threat of consumer desertion will compel the LECs to maintain appropriate service levels once truly effective competition has evolved.

It is disingenuous, however, for the LECs to seek relaxed reporting for themselves once competition has evolved, yet argue in the same breath that the Commission should apply their same service reporting requirements, as Ameritech recommends, "equally to all industry participants."[162] Further, US WEST suggests, "if the Commission finds quality of service and infrastructure reporting requirements to be in the public interest, such reporting requirements should not

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[160] MCI Comments, p. 51 (arguing that where fully effective competition exists, monitoring is extraneous because risk of losing customers provides necessary incentive for service providers to maintain high operating standards).

[161] BellSouth Comments, p. 59. See also, GTE Comments, pp. 79-80; and Southwestern Bell Comments, pp. 62-63.

[162] Ameritech Comments, p. 20, (footnote omitted).

be limited to price cap LECs," and it urges the requirements to be extended to LECs, IXCs, and CAPs.[163] BellSouth, too, envisions a parallel between meeting the public interest and applying reporting requirements to "**all** service providers who use the network."[164] The LECs' cry for quid pro quo reporting for all telecommunications providers is self-serving, and the Commission should reject it. So long as reasonable maintenance levels can be maintained through market forces -- as clearly is the case for nondominant IXCs (and to a significant degree, AT&T) and CAPs, whose customers can readily abandon their providers for an alternative source, the public interest of reliable telecommunications service is achieved.[165] To attain this public interest objective for LEC services, however, it is necessary to maintain their reporting requirement because their customers lack alternatives available if service quality for such crucial telecommunications services degrades.

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[163] US WEST Comments, p. 50, (footnote omitted).

[164] BellSouth Comments, p. 58.

[165] Although competition is beginning to invade the LECs' historical monopoly markets, it has not developed to the point it has in other markets that enables it to force the service provider to maintain high service standards. For example, nondominant IXCs (as well as, to a significant degree, AT&T) and CAPs face effective competition everywhere they provide service, while LECs do not. Generally, nondominant carriers must offer the highest quality of service to their potential customers in order to attract them away from the LECs.

<u>Baseline Issue 7b</u>: Whether and if so how the Commission should expand its service quality monitoring to include price cap LEC facilities and services that may be interconnected with the local exchange network or used to provide similar capabilities, including wireless services and coaxial cable.

In its comments, MCI argued that there was no need to expand service reporting requirements to non-access services because either "alternative regulations provide monitoring for other services" or "the services are subject to competition, and therefore, rely upon the market to ensure adequate service quality."[166] Pacific also suggests that telephone service reporting should be a separate issue from other reporting since it is likely that disparate reporting requirements would apply to different service types.[167] Further, Ameritech avers that it would be too costly to extend current reporting requirements to cover other services.[168] Finally, NYNEX correctly notes that "[i]t is premature to prescribe service quality monitoring requirements for services or facilities that have yet to be deployed."[169] For all these reasons, MCI recommends that the Commission make no changes to reporting requirements at this time.

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[166] MCI Comments, p. 52.

[167] Pacific Telesis Comments, pp. 58-64.

[168] Ameritech Comments, p. 21. MCI does not believe, however, that cost is the sole factor that would determine whether any monitoring system was appropriate. Here, it is one of several factors that suggests expansion of the requirement is not necessary. In other instances, the cost, though high, may well be irrelevant.

[169] NYNEX Comments, p. 55.

BASELINE ISSUE 8: RATES AND REGULATIONS FOR NEW SERVICES

Baseline Issue 8a: Whether the LEC price cap new services requirements impose unnecessary regulatory impediments to the development and introduction of new services, with specific identification of what those impediments are and an assessment of their magnitude.

In its comments, MCI demonstrated that removal of the current cap on new service prices affords the LECs undue "headroom" in the basket into which they place new services. That is, "if new services rates are incorporated into price caps at a level in excess of costs, LECs can easily raise other rates in a category or basket."[170] A further concern is that it is necessary to initialize new service rates so that they comport with the underlying legal predicate of price caps that initial "rates bear some reasonable relationship to cost."[171] MCI maintains that retention of the cap on new services is critical to ensure that price cap regulation does not provide LECs with undue flexibility at the expense of its monopoly ratepayers. Otherwise, LECs will have both the incentive and the opportunity to bring new services into the cap with the primary intention of creating undue upward rate flexibility for their existing services. US WEST, essentially conceding that LECs are motivated by their ability to manipulate rates suggests that "new service[s] should be integrated within the price cap mechanism upon approval of the tariff, permitting a LEC greater flexibility to adjust prices to meet customer needs."[172] If the Commission discards the price ceiling for LEC new services,

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[170] MCI Comments, p. 53.

[171] Id.

[172] US WEST Comments, pp. 57-58 (emphasis added).

higher prices for monopoly services will be forced upon captive ratepayers as the LECs manipulate the baskets' upper limits.

Several LECs respond that market forces will constrain the price of new services, and that a ceiling is thus unnecessary.[173] Such an argument is one sided and misses the point. The concern should not be whether purchasers of new services are paying "reasonable" rates, but whether the rates charged are cost-based. That is, rates that are considered "reasonable" for new services that have not yet faced significant competition may still be well above cost -- and, thus, beyond the cost-based definition of "reasonable" necessary for the rates of services included in the price cap.

MCI opposes MFS Communications Company, Inc.'s suggestion that "new services should be incorporated into price caps immediately upon becoming effective."[174] This is because historical demand data, without which it is impossible to compute the actual price index and SBI, is not available. Any estimate of demand, especially regarding the migration of demand from existing services to new services would be highly speculative. Inaccurate demand data

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[173] See, e.g., Ameritech Comments, p. 25 (relying on market to provide reasonable ceiling on optional LEC services); Bell Atlantic Comments, p. 25 (contending that market will constrain new service prices; or competitive entry will occur); BellSouth Comments, pp. 63-64, (footnote omitted) (focusing on customer decisions not to purchase new service if it is priced unreasonably high); and USTA Comments, p. 75 (linking market-specific degree of competition to level of required cost support for new service offering).

[174] MFS Communications Company, Inc. Comments, p. 26, (footnote omitted).

will skew the cost/rate relationship of new services and could provide the LECs with undue flexibility for pricing their existing services.

If the Commission nonetheless decides to allow the LECs additional pricing flexibility, it should also adopt a methodology that prevents the LECs from manipulating the cap on monopoly services, as discussed supra. MCI recommends that the Commission either require LECs to price new services at cost plus a reasonable overhead; or alternatively, to require the LECs make compensating decreases in existing service prices to ensure that there is no change in the relevant basket's actual price index. In this manner, the LECs would obtain the flexibility they pursue, while ratepayers would be somewhat protected from unjustified increases in access service rates.

Additionally, several commenting parties seek shorter notice periods for new services. Ameritech, for example, suggests streamlined regulatory treatment for new services with tariffs being effective on 1 day's notice.[175] USTA and those LECs supporting USTA's proposal argue for a 14 day notice period (with no cost showing) for new services introduced into competitive market areas.[176] US WEST supports a 14 day notice period in all market areas,[177] while BellSouth

[175] Ameritech Comments, p. 21. Ameritech also seeks modification of the Commission's rules to eliminate the waiver requirement for establishing new rate elements. Such a proposal is outside the scope of this proceeding and is best considered in the context of a Part 69 access charge review.

[176] USTA Comments, pp. 76-77.

[177] US WEST Comments, p. 55.

prefers 30 days.[178] Finally, USTA would allow services in transitional market areas to be effective on 21 day's notice, though it would retain the 45 days' notice for services introduced in initial market areas.[179]

The current 45 day notice period is necessary in order to provide access customers with adequate time to review the new services' rates and cost support. None of the commenting LECs has provided any substantial rationale for shortening the notice period. In fact, USTA essentially supports maintaining the status quo for market areas characterized by the existing level of competition.[180] Regardless of whether the Commission considers USTA's plan (and MCI recommends that it not adopt the plan), it is nonetheless relevant that USTA recommends a 45 day review period for new services introduced in initial market areas -- the equivalent of today's LEC study areas.[181] Thus, until effective competition develops, MCI urges the Commission to maintain the current 45 day notice period.

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[178] BellSouth Comments, pp. 64-65.

[179] USTA Comments, pp. 75-76.

[180] See supra note 180.

[181] Id.

Baseline Issue 8b: Whether, and how, the Commission should modify the LEC price cap new services procedures and cost support rules to ensure that these rules advance our goals of encouraging innovation and setting reasonable rates.

The LECs have been unable to demonstrate that the ceiling requirement for new service prices has restrained their incentive to introduce new services or harmed them in any other fashion. As Sprint notes, "the new services test has not prevented price cap LECs from introducing new services."[182] MFS agrees that "LEC tariff filings over the past three years clearly belie the arguments that LECs lack incentive to deploy new technology or initiate new services."[183] No harm will befall the LECs if the Commission retains its new services rules; yet the IXCs and other ratepayers will be subject to unjustified rate increases for monopoly services if the ceiling is removed. For these reasons, MCI urges the Commission to make no changes to the price cap new services rules.

Baseline Issue 8c: Whether new services are available on an equal basis to all LEC customers. Whether the Commission should revise the LEC price cap plan to ensure the universal availability of new services. How widely LECs have made new services available to customers.

MCI has not experienced any undue delays in receiving new access services, features, or functions, and therefore does not offer futher comments on whether the Commission should regulate new service availability beyond the informal negotiations that currently are a part of the tariff review process.

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[182] Sprint Comments, p. 21.

[183] MFS Communications Company, Inc. Comments, p. 22.